

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

IN RE:	*	
	*	
AMERICAN PAPER GROUP, INC.,	*	
et al.,		CASE NUMBER 02-45101
	*	
Debtors.	*	
	*	

	*	
AMERICAN PAPER GROUP, INC,	*	
CREDITOR TRUST,	*	
	*	
Plaintiff,	*	
	*	
vs.	*	ADVERSARY NUMBER 04-4229
	*	
MEDICAL MUTUAL OF OHIO,	*	
	*	
Defendant.	*	
	*	

M E M O R A N D U M O P I N I O N

The matter before the Court is the Motion of Medical Mutual of Ohio to Dismiss Pursuant to Fed. R. Civ. P. 12(b)(6) (the "Motion to Dismiss") filed by Defendant Medical Mutual of Ohio ("Medical Mutual") and American Paper Group, Inc. Creditor Trust's Brief in Opposition to Medical Mutual of Ohio's Motion to Dismiss (the "Creditor Trust's Opposition") filed by Plaintiff American Paper Group, Inc., Creditor Trust (the "Creditor Trust"). This Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b). This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B), (F) and (O).

BACKGROUND

The Creditor Trust was established pursuant to Order of the Court entered on December 22, 2003 Confirming Debtors' Consolidated Plan of Liquidation (the "Confirmation Order") and Article 6 of the Consolidated Plan of Liquidation of American Paper Group, Inc. and its Debtor Affiliates (the "Plan"). Debtor American Paper Group, Inc. ("American Paper") and its debtor affiliates commenced voluntary Chapter 11 cases under Chapter 11 of Title 11, United States Code (the "Bankruptcy Code"), on November 6, 2002. Pursuant to the Confirmation Order and the Plan, the Creditor Trust was authorized to pursue certain transfers made by American Paper to or for the benefit of certain entities during the 90-day period prior to the commencement of the bankruptcy cases.

On November 5, 2004, the Creditor Trust timely filed the Complaint to Avoid Preferential Transfers against Medical Mutual, which is the instant adversary proceeding. On December 9, 2004, Medical Mutual timely filed the Motion to Dismiss, and in response thereto, on January 24, 2005, the Creditor Trust filed the Creditor Trust's Opposition. On February 2, 2005, Medical Mutual filed Defendant Medical Mutual of Ohio's Reply to Brief in Opposition to Motion to Dismiss (the "Medical Mutual Reply") and subsequently filed Defendant Medical

Mutual of Ohio's Supplement to its Reply to Brief in Opposition to Motion to Dismiss (the "Supplement") on March 17, 2005.¹

This adversary proceeding alleges that American Paper paid to Medical Mutual not less than Six Hundred Thousand One Hundred Fifty-Three and 15/100 Dollars (\$600,153.15) during the 90-day period prior to the petition date. The Complaint alleges the following elements: (1) the avoidable transfers were to or for the benefit of Medical Mutual, a creditor of American Paper; (2) the avoidable transfers were on account of antecedent debt(s) owed by American Paper to or for the benefit of Medical Mutual before such transfers were made; (3) the avoidable transfers to or for the benefit of Medical Mutual were made while American Paper was insolvent; and (4) the avoidable transfers enabled Medical Mutual to recover more than it would have received if the avoidable transfers had not been made, the case were a case under Chapter 7 of the Bankruptcy Code, and Medical Mutual received payment of its debt to the extent provided by the provisions of Title 11 of the Bankruptcy Code. As a consequence, the Creditor Trust alleges that such transfers are avoidable transfers pursuant to 11 U.S.C. § 547(b) and that it is entitled to recover such preferential transfers pursuant to 11 U.S.C. § 550. The

¹This Supplement merely submitted a reported copy of the decision *Zenith Industrial Corp. v. Longwood Elastomers, Inc.* (*In re Zenith Industrial Corp.*), 319 B.R. 810 (Bankr. D. Del. 2005), which had been attached in its unreported form to the Medical Mutual Reply.

Creditor Trust further alleges that any claims by Medical Mutual should be disallowed pursuant to 11 U.S.C. § 502(d) until such time as Medical Mutual pays to the Creditor Trust an amount equal to the aggregate amount of the avoidable transfers.

MEDICAL MUTUAL'S MOTION TO DISMISS

The Motion to Dismiss alleges that the Complaint fails to state a claim upon which relief can be granted under § 547 of the Bankruptcy Code or any other theory asserted by the Creditor Trust. Medical Mutual states that on November 6, 2002, American Paper filed its Motion for Order Authorizing Payment of Pre-Petition Compensation, Benefits, Employee Reimbursements and Withholding Taxes and Directing the Bank to Honor Pre-Petition Checks for these Amounts (the "Benefits Motion"). Pursuant to the Benefits Motion, American Paper requested that this Court permit it to pay certain compensation, which included payment of wages, salaries, reimbursement of out-of-pocket business related expenses, accrued vacation and sick leave, amounts due on behalf of employees to FICA and premiums and claim payments under American Paper's health, life and disability insurance plans. On November 7, 2002, the Court entered an Order Granting Motion for an Order Authorizing Payment of Pre-Petition Compensation, Benefits, Employee Reimbursements, Withholding Taxes and Directing the Bank to Honor Pre-Petition Checks for these Amounts (the "First Day Benefits Order"). The First Day

Benefits Order stated:

Based upon the Debtor's representations, the Court finds that if Debtor is not permitted to pay certain pre-petition compensation, benefits, employee reimbursement and withholding taxes, Debtor's ability to conduct its day-to-day operations will be detrimentally affected and the likelihood of a successful sale pursuant to 11 U.S.C. § 363 will be substantially reduced.

Decretal paragraph 3 of the First Day Benefits Order provided:

That Debtor is authorized to pay, so long as the payments do not exceed the applicable amounts in the Budget, various employee benefits, including medical coverage, workers' compensation coverage, paid vacations to the extent taken in the period from October 17, 2002 through the Petition Date, payroll deductions for charitable donations and compliance with garnishment orders that may have accrued during such period but prior to the Petition Date[.]

Medical Mutual relies on the First Day Benefits Order² to argue that, even accepting the facts as alleged in the Complaint to be true, it is not possible for the Creditor Trust - under any set of facts or circumstances - to prove that Medical Mutual received an avoidable transfer under § 547 of the Bankruptcy Code.

Medical Mutual argues that, in order to successfully prove Medical Mutual received an avoidable preference, the Creditor Trust has to prove each and every element of § 547(b) of the Bankruptcy Code. Section 547(b) provides that:

²Medical Mutual requests this Court to take judicial notice of the history of this bankruptcy case and its prior orders. Since these matters are all filed of record, the Court will take such judicial notice.

(b) Except as provided in subsection (c)
. . . the trustee may avoid any transfer of
an interest of the debtor in property --

(1) to or for the benefit of a
creditor;

(2) for or on account of an antecedent
debt owed by the debtor before such transfer
was made;

(3) made while the debtor was
insolvent;

(4) made --

(A) on or within 90 days before
the date of the filing of the petition;
or

. . .

(5) that enables such creditor to
receive more than such creditor would receive
if --

(A) the case were a case under
chapter 7 of this title;

(B) the transfer had not been
made; and

(C) such creditor received payment
of such debt to the extent provided by
the provisions of this title.

Medical Mutual asserts that the Creditor Trust cannot
prove that the transfers received by Medical Mutual enabled it to
receive more than it would have under a hypothetical Chapter 7
liquidation. Medical Mutual argues that, for purposes of the
§ 547(b)(5) liquidation analysis, Medical Mutual's hypothetical
recovery must take account of its actual status in the case.

Unlike general unsecured creditors, [Medical

Mutual] is the beneficiary of an order entered by this Court that authorizes the Debtors to pay [Medical Mutual] the amounts owed to it prepetition under the Insurance Contract. See the [First Day] Benefits Order. The [First Day] Benefits Order authorized payments for employee health benefits. Therefore, as a result of the [First Day] Benefits Order, [Medical Mutual] would have been entitled to receive any unpaid amounts owed to it under the Insurance Contract. Accordingly, such payments are unavoidable and the Plaintiff's Complaint must be dismissed as a matter of law.

See, Motion to Dismiss, at 6-7. In support of this position, Medical Mutual cites to *Official Committee of Unsecured Creditors v. Medical Mutual of Ohio (In re Primary Health Services)*, 275 B.R. 709, 711 (Bankr. D. Del. 2002), *aff'd* C.A. No. 02-301 (D. Del. Feb. 27, 2003). Medical Mutual argues that, because it did not receive more than it would have under a hypothetical Chapter 7 liquidation, the Creditor Trust is unable to demonstrate, under any circumstances, all of the elements required by § 547(b).

CREDITOR TRUST'S OPPOSITION

The Creditor Trust argues that the Motion to Dismiss fails to meet the stringent burden of Federal Rule of Civil Procedure 12(b)(6) and, accordingly, must be denied. The Creditor Trust argues that it is not required to prove all of the essential elements of its claims in its Complaint but is only required to satisfy the pleading requirements under Federal Rule of Civil Procedure 8(a). The Creditor Trust contends that it has

fulfilled that obligation and that its Complaint satisfies the pleading requirements under Federal Rule of Civil Procedure 8(a). The Creditor Trust argues that Medical Mutual "apparently" recognizes the sufficiency of the Complaint by asking the Court to look beyond the pleadings and take judicial notice of the First Day Benefits Order. The Creditor Trust argues that there is a factual dispute between Medical Mutual and the Creditor Trust as to whether the transfers made to Medical Mutual constituted less than Medical Mutual would have received if the case were a Chapter 7 liquidation and, thus, Medical Mutual's Motion to Dismiss is improper.

**THE FIRST DAY BENEFITS ORDER AS
A BAR TO AVOIDANCE ACTIONS**

The parties have cited numerous cases dealing with "first day" orders and the issue of whether payment pursuant to certain first day orders eliminates a debtor's right to recover avoidable preferences. The case law is clear that there is a difference between "critical vendor" orders which authorize - but do not direct - the debtor to make certain pre-petition payments to vendors that it deems to be critical, in its discretion, to the continued viability of the company as opposed to orders such as the assumption of an executory contract whereby the cure payments are mandatory (rather than discretionary) and, consequently, cannot be the subject of an avoidable preference action. See *HLI Creditor Trust v. Export Corp.* (*In re Hays*

Lemmerz International, Inc.), 313 B.R. 189, 193 (Bankr. D. Del. 2004) ("[E]ven if Export had received some payments under the Critical Vendor Order, it does not follow that it was entitled to receive payment of all pre-petition claims. The Order was permissive, not mandatory."). Cf. *In re Superior Toy & Manufacturing Co., Inc.*, 78 F.3d 1169, 1174 (7th Cir. 1996) ("An assumption order divests the trustee of subsequent claims to monies paid under the contract whether they were paid prepetition or postpetition.").

Medical Mutual cites to *Primary Health Services*, which is a strikingly similar case. In *Primary Health Services*, the court specifically recognized that a payment made pursuant to authoriza-tion granted in a benefits order previously entered by the court was protected from subsequent recovery as a preferential transfer. Although the *Hays Lemmerz* court declined to follow *Primary Health Services*, it did so on the basis that the parties sought protection under a permissive critical vendor order rather than a mandatory payment order.

Medical Mutual also cites to *Zenith Industrial Corp.*, 319 B.R. at 816, in which

Judge Fitzgerald rejected the notion that her ruling in *Primary Health* stood for this general proposition. The most significant difference between the circumstances in *Primary Health* and in *U.S. Office Products* was that the order authorizing payment of pre-petition obligations in *Primary Health*

authorized the debtor to pay claims of employees who held priority claims. . . . In *U.S. Office Products*, the critical vendor order authorized the debtor to pay general unsecured claims.

This Court finds the reasoning of *Primary Health Services* to be applicable here. The First Day Benefits Order authorized American Paper to pay certain compensation and other benefits, including payment of medical health insurance premiums and claims. These are the same kind of pre-petition claims for which the Creditor Trust seeks avoidance in its Complaint. American Paper sought and obtained mandatory - not permissive - authority of the Court to pay these pre-petition claims to Medical Mutual. The Creditor Trust is thus now estopped from seeking to avoid payments that would have been paid pursuant to the First Day Benefits Order if they had not been paid during the 90-day pre-petition period.

The Creditor Trust argues that a motion to dismiss is improper at this stage because Medical Mutual has raised a factual dispute with respect to whether it received more than it would have under a Chapter 7 liquidation analysis. This Court finds, however, that application of the prior First Day Benefits Order as a bar to this preference action is a legal question, rather than a factual dispute. Furthermore, the Creditor Trust argues that Medical Mutual's Motion to Dismiss is insufficient because the Creditor Trust has stated all the elements it needs

to plead pursuant to Federal Rule Civil Procedure 8(a). The Creditor Trust pled the basic elements of a preference action in a conclusory way. However, the Creditor Trust cannot establish the elements of § 547(b)(5) since, as a matter of law, entry by this Court of the First Day Benefits Order authorized and required American Paper to pay Medical Mutual pre-petition amounts relating to unpaid premium claims and benefit claims, which are the type of pre-petition payments for which the Creditor Trust seeks avoidance. Accordingly, Medical Mutual's Motion to Dismiss is granted.

An appropriate order shall enter.

HONORABLE KAY WOODS
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
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MEDICAL MUTUAL OF OHIO, *
*
Defendant. *
*

O R D E R

For the reasons set forth in this Court Memorandum
Opinion entered this date, the Motion of Medical Mutual of Ohio
to Dismiss Pursuant to Fed. R. Civ. P. 12(b)(6) is granted.

IT IS SO ORDERED.

HONORABLE KAY WOODS
UNITED STATES BANKRUPTCY JUDGE

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing
Memorandum Opinion and Order were placed in the United States

Mail this _____ day of April, 2005, addressed to:

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